

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 05-0488

Income Tax

For Tax Years 2001-03

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ISSUE

I. Income Tax—Corporate

Authority: 45 IAC 3.1-1-153

Taxpayer protests the imposition of additional corporate income tax.

II. Tax Administration—Negligence Penalty

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer operates a residential service business which operates in all fifty states. As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for the tax years 2001, 2002, and 2003. Taxpayer protests these assessments. Further facts will be supplied as required.

I. Income Tax—Corporate

DISCUSSION

Taxpayer protests the imposition of additional adjusted gross income tax. The Department conducted its fieldwork at taxpayer's parent company's headquarters and, due to scheduling exigencies, concluded its audit using the best information available by means of data already in the Department's records. After reviewing this data, the Department adjusted taxpayer's apportionment percentages for determining adjusted gross income tax. Taxpayer protests the adjustments and believes the original percentages were correct.

In reaching its decision, the Department referred to 45 IAC 3.1-1-153, which states:

- (a) A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income.
- (b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year, with the following modifications:
 - (1) The value of property which is rented or leased by the corporate partner to the partnership or vice versa shall, with respect to the corporate partner, be excluded from the property factor of the partnership or eliminated to the extent of the corporate partner's interest in the partnership, whichever the case may be, in order to avoid duplication.
 - (2) Intercompany sales between the corporate partner and the partnership shall be eliminated from the corporate partner's sales factor as follows:
 - (A) Sales by the corporate partner to the partnership to the extent of the corporate partner's interest in the partnership.
 - (B) Sales by the partnership to the corporate partner not to exceed the corporate partner's interest in all partnership sales.
- (c) If the corporate partner's activities and the partnership's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows:
 - (1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.
 - (2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.
- (d) A partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.
- (e) After determining the amount of business income attributable to Indiana under subsection (c), the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and

it nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income.

The Department cited inconsistencies between taxpayer's Indiana returns and Federal returns as the reasons that taxpayer should have been including a larger amount of Indiana-related income in the apportionment calculations. When the Department added these amounts and recalculated the apportionment figures, taxpayer's Indiana apportionment percentages grew as did the amount of Indiana adjusted gross income tax. The Department's stated reasons for adding in the larger amounts to the apportionment calculations were inconsistencies between taxpayer's Indiana returns and Federal returns.

Taxpayer protests that it reported the correct amounts on its Federal and Indiana returns. Through documentation submitted during the protest process, taxpayer established that the perceived inconsistencies were based on the Department's reliance on the best information available. The new documentation provided by taxpayer is sufficient to establish that taxpayer did use the correct apportionment factors in the returns it filed with the Department.

Taxpayer also protests that the Department incorrectly reversed an addback of bonus depreciation. The Department's reason to reverse the addback was that it could not confirm that taxpayer had taken the bonus depreciation on its Federal return. As part of this protest, taxpayer has provided documentation showing that it did take the bonus depreciation on its Federal returns, thereby answering the Department's reason to reverse the addback on the Indiana return.

Taxpayer also protests the Department's decision to addback state taxes to taxpayer's income. The Department based its decision on the fact that the best information available indicated a different amount reported on the Federal and Indiana returns. As part of this protest, taxpayer has established that it reported the correct amount on both returns.

In conclusion, taxpayer reported the correct amount of Indiana adjusted gross income and Indiana adjusted gross income tax. The apportionment percentages were correct as originally reported. The bonus depreciation was correctly reported on the original returns. The state taxes listed for deduction were correctly reported on the original returns.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Negligence Penalty

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer did not incur a deficiency which was due to negligence under 45 IAC 15-11-2(b), and so is not subject to a penalty under IC 6-8.1-10-2.1(a). Taxpayer has affirmatively established that there was no failure to pay a deficiency, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is sustained.

WL/DP/DK September 18, 2006